



Investor Letter First Quarter 2026

Market Review

Stock prices fell in the first quarter of 2026. The S&P 500 Total Return Index fell 4.3% during the quarter while the NASDAQ 100 Index fell 5.8%. The Barclays Bond Aggregate Index was unchanged. In the first two months of the quarter, markets were dominated by economic and AI news, while in March the focus shifted to the war in Iran. Oil prices rose dramatically in March after the war started.

In January and February, US companies released earnings for the fourth quarter of 2025, and on balance they were very strong. Overall, fourth quarter earnings for S&P 500 companies rose 14%, marking the fifth consecutive quarter of double digit earnings growth. Earnings from top tech firms rose 27% (above the 20% estimate) and earnings for non-tech companies rose 5-7%. Looking forward, expectations for earnings continue to be encouraging. Analysts are expecting another strong quarter of results for the first quarter of 2026, with an 11-13% projected increase in earnings.

During the quarter there was a rotation in stock market leadership from growth stocks to value. For the quarter, value stocks outperformed growth stocks by 10-11%. This change in leadership reflected a normal shift after a long period of outperformance by growth managers.

In the past six weeks, financial and geopolitical news has been dominated by the war in Iran. We have written two Investor Letters since the beginning of the war, mostly encouraging investors not to overreact to the current conflict (or geopolitical events in general.) The situation in Iran is evolving day to day, and it is impossible to know how it will ultimately be resolved. The stock market fell for the first few weeks after the war began and has rallied since. Since the beginning of the war, the overall change in the S&P 500 has been less than one percent (as of April 13).

Artificial Intelligence and Its Impact on Jobs

Investment in artificial intelligence continues to be a key driver of the economy. As we noted in a mid-quarter letter, concerns about AI have shifted from whether these investments will pay off to whether they will prove so disruptive that significant companies, or even entire industries, will be threatened. OpenAI recently released a policy paper calling on the government to act to offset some of these concerns. There is no doubt AI will have a profound impact on the economy. As with most new technologies, the magnitude and shape of the disruption is likely to be overestimated in the short term and underestimated in the long term.

One common worry is that AI will become so efficient that it will reduce the demand for labor, leaving large portions of the population without work. While there will be significant disruptions in parts of the economy, concerns of mass unemployment may be overstated. This policy concern assumes that there is a finite amount of work to be done, and that if AI takes on a large portion of it, there will be less work left for people to do. In reality, there are many tasks that could be done each day which are not done because they are not economically justifiable. AI may change that equation, making many things economically viable that previously were not. In the terminology of Economics 101, AI shifts the supply curve to the right: meaning that more work can be supplied for a given cost. In practice, an office worker may produce more or better reports than before. Or a factory worker, with a robot to handle routine tasks, may be free to focus on quality control or take on more skilled work.

In addition, it is almost certain that new uses for AI will emerge that no one has thought of yet. This is always the case with a new technology: the first applications people imagine are simply replacements for what they already do. Only later does a technology's true potential become clear. When the internet arrived, people recognized they could look something up without going to the library or send a note without visiting the post office. Nobody envisioned entire new industries such as social media. When the automobile was invented, people thought it would replace the horse. Nobody envisioned the interstate highway system or the rise of the suburbs.

The likely result is that even with AI, people will be as busy as ever, just more productive and often doing things they had not previously imagined. In fact, stories are already emerging of workers who feel stressed because they now have several AI agents working for them and struggle to keep up with the output. That is what always happens with a new technology. Is anyone actually less busy because of inventions such as the automobile, the airplane, the personal computer, or the mobile phone? No, people are busier than ever. In the end, technology makes us more efficient, but not less busy.

Book Report: *Buffett's Early Investments*, by Brett Gardner

Anyone who follows the investment world is familiar with Warren Buffett, who recently stepped down as chairman of Berkshire Hathaway. With his humility, sense of humor, and remarkable long-term investment record, he has become a model for what many believe a successful investor should be. His well-known investments in companies such as Coca-Cola, GEICO, and American Express are familiar to most investors.

Less well known, however, are Buffett's earliest investments made when he was relatively unknown and managing far smaller amounts of capital. During this period, he operated in a very different part of the market, focusing on smaller, often overlooked companies where significant valuation discrepancies were more common.

That is why there has been considerable interest in a recent book, *Buffett's Early Investments* by Brett Gardner. Rather than offering a traditional biography, Gardner revisits a number of Buffett's early investments and reconstructs them using only the information that would have been available at the time. The result is a detailed look at how Buffett actually made decisions in real time.

One example is Union Street Railway, which despite its name was an operator of buses in New England when it was purchased by a 24 year old Buffett in 1954. Union Street was not profitable at the time Buffett purchased it, but the price was very cheap. The company's stock was trading for only half the value of its cash and similar assets after accounting for all debt. Eventually the company launched a share repurchase program and also paid a large special dividend to shareholders, making this an early success for Buffett.

Another good example is Buffett's 1954 investment in Philadelphia and Reading Coal and Iron Company. Operating in the anthracite coal industry, the company traded at a steep discount to readily identifiable assets. Buffett initially purchased shares around \$18-\$20 and added aggressively when the stock fell to \$9. At this point, the company held about \$8 per share in net cash and liquid assets, meaning he was effectively paying little for the actual business. In addition, the company had a hidden asset consisting of culm banks, a mining waste product that had historically been discarded but was becoming economically viable as a fuel source due to new technology. The value of this asset was estimated to be \$5-8 per share. The low stock price, high cash level and hidden asset made this an attractive investment for Buffett.

The outcome of this investment was ultimately driven by both asset value and corporate change. An outside investor group eventually accumulated a meaningful stake and helped to lead a shift away from coal, with capital redeployed into textiles and other businesses. These moves helped the stock price, and this became a successful investment for Buffett. This case study is also notable because it foreshadowed Buffett's later approach with Berkshire Hathaway: acquiring statistically cheap, asset-rich companies not for the quality of their existing business, but as platforms for capital redeployment into more attractive opportunities.

These examples reflect what is sometimes described as “cigar butt” investing—buying businesses with limited long-term prospects but enough value in cash and other current assets to justify a profitable investment. They also highlight Buffett’s practice of acting very much like today’s activist investors in the sense that he would seek to influence decisions of management or the board of directors for a company to take actions which were in shareholders’ interest.

Perhaps most importantly, the book highlights how Buffett evolved as an investor. Over time, influenced in part by Charlie Munger, he shifted away from purely statistical bargains toward higher-quality businesses with durable competitive advantages. This transition—from buying “cheap” companies to buying “great” companies at reasonable prices—became a defining feature of his later success.

The underlying philosophy of value investing still underlies the investment process of some outstanding investment managers. Among the firms we use, Harris Associates and Dodge & Cox are two which are highly influenced by Buffett’s philosophy. Both firms emphasize fundamental, bottom-up research, a long-term investment horizon, and a willingness to invest in companies that are temporarily out of favor but trading at a discount to intrinsic value. Like Buffett, they focus on downside protection—seeking to understand what a business is worth under conservative assumptions—and are comfortable being patient while that value is realized.

At the same time, these managers reflect Buffett’s evolution as well. While early Buffett often invested in smaller, more obscure situations or special situations where he could influence outcomes, firms like Harris Associates and Dodge & Cox tend to focus on larger, more established businesses with durable franchises. In this sense, they combine elements of Buffett’s early discipline with the later emphasis--shaped in part by Charlie Munger--on owning quality businesses at reasonable prices. We believe managers who consistently apply these principles over the long-term will be rewarded.

Thank you as always for being a client. Please feel free to reach out to Roger or me if you would like to discuss your portfolio or any of the topics discussed in this letter.

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